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70126

## BEFORE THE ARIZONA CORPORATION COMMISSION

MIKE GLEASON  
Chairman  
WILLIAM A. MUNDELL  
Commissioner  
JEFF HATCH-MILLER  
Commissioner  
KRISTIN K. MAYES  
Commissioner  
GARY PIERCE  
Commissioner

Arizona Corporation Commission<sup>1</sup>

DOCKETED

JAN 23 2008

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IN THE MATTER OF THE APPLICATION ) DOCKET NO. T-03267A-07-0554  
OF PAETEC HOLDING CORP., )  
MCLEODUSA INCORPORATED AND ) DECISION NO. 70126  
MCLEODUSA TELECOMMUNICATIONS )  
SERVICES, INC. FOR APPROVAL TO ) ORDER  
TRANSFER INDIRECT CONTROL OF )  
MCLEODUSA TELECOMMUNICATIONS )  
SERVICES, INC. AND FOR MCLEODUSA )  
TELECOMMUNICATIONS SERVICES, )  
INC. TO PARTICIPATE IN CERTAIN )  
DEBT FINANCING ARRANGEMENTS )

Open Meeting  
January 15 and 16, 2008  
Phoenix, Arizona

BY THE COMMISSION:

FINDINGS OF FACTINTRODUCTION

On September 27, 2007, PAETEC Holding Corp. ("PAETEC") and McLeodUSA Incorporated ("McLeodUSA Parent") filed an Application requesting expedited approval under A.R.S. § 40-285 and A.A.C. R14-2-803 and R14-2-804.B.1, to the extent necessary, as well as any other applicable statutes or rules, for the transfer of indirect control of McLeodUSA Telecommunications Services, Inc. ("McLeodUSA") from McLeodUSA Parent to PAETEC and for McLeodUSA to participate in PAETEC's debt financing arrangements. Additionally, the Applicants requested approval to issue guarantee and to pledge or encumber assets.

The transfer of control will result from PAETEC's proposed acquisition of McLeodUSA Parent through the merger of McLeodUSA Parent with a newly formed subsidiary of PAETEC ("PS Acquisition Corp."). Following the merger, McLeodUSA Incorporated will be the surviving

entity. No transfer of certificate, assets, or customers will occur as a result of the transfer of control or McLeodUSA's participation in the debt financing. McLeodUSA will continue to provide service to its Arizona customers under its existing certificate with no change in the rates, terms, or conditions of service as currently provided.

#### THE PARTIES

McLeodUSA Parent and PAETEC in their Application and through data responses represent the following:

1. McLeodUSA is a corporation organized under the laws of Iowa with a principal place of business located at One Martha's Way, Hiawatha, Iowa 52233. McLeodUSA currently provides telecommunications services in 48 States. McLeodUSA offers local service in the following 25 States:

Arizona	Indiana	Michigan	Nebraska	Oklahoma	Utah
Arkansas	Iowa	Minnesota	New Mexico	Oregon	Washington
Colorado	Kansas	Missouri	North Dakota	South Dakota	Wisconsin
Idaho	Louisiana	Montana	Ohio	Texas	Wyoming
Illinois					

2. In Arizona, McLeodUSA is authorized to provide resold and facilities-based local exchange and exchange access telecommunications services pursuant to Decision No. 62627, granted June 9, 2000. McLeodUSA is also authorized to provide resold interexchange telecommunications services pursuant to Decision No. 61001, granted July 16, 1998.

3. McLeodUSA is a wholly-owned subsidiary of McLeodUSA Holdings, Inc, which is a wholly-owned subsidiary of McLeodUSA Parent. McLeodUSA currently provides service to approximately 3,142 business and residential customers in the State of Arizona. McLeodUSA and the other Arizona affiliates<sup>1</sup> of McLeodUSA Parent employ approximately 18 people in Arizona.

4. McLeodUSA Parent is a privately-held Iowa company headquartered in Cedar Rapids, Iowa. Through its operating subsidiaries, McLeodUSA Parent currently owns and operates a high-capacity fiber network that spans 20 Midwest, Southwest, Northwest, and Rocky

<sup>1</sup> The additional Arizona affiliates of McLeodUSA Parent include: McLeodUSA Information Services, Inc., McLeodUSA Network Services, Inc., and McLeodUSA Purchasing, LLC.

Mountain States. The fiber network contains approximately 13,000 intercity route miles and approximately 4,000 metro route miles. McLeodUSA Parent provides telecommunications services primarily to small and medium-sized enterprise and multi-location commercial customers.

5. PAETEC is a publicly traded corporation under the laws of Delaware with a principal place of business located at One PAETEC Plaza, 600 Willowbrook Office Park, Fairport, New York 14450. Through its operating subsidiaries, PAETEC currently provides telecommunications services to more than 45,000 medium and large business customers in major metropolitan areas in 24 states. Collectively, the 12 wholly-owned subsidiaries operate in 48 States and the District of Columbia. PAETEC is currently certified to provide local service in the following 35 States listed below, plus the District of Columbia;

Alabama	Georgia	Maryland	Nevada	Ohio	Texas
California	Illinois	Massachusetts	New Hampshire	Oregon	Utah
Colorado	Indiana	Michigan	New Jersey	Pennsylvania	Vermont
Connecticut	Kansas	Minnesota	New Mexico	Rhode Island	Virginia
Delaware	Kentucky	Mississippi	New York	South Carolina	Wisconsin
Florida	Louisiana	Missouri	North Carolina	Tennessee	

6. In Arizona, PAETEC's two subsidiaries, PAETEC Communications, Inc. ("PCI") and US LEC Communications, Inc. ("US LEC"), are authorized to provide resold intrastate interexchange telecommunications services. PCI is authorized to provide service pursuant to Decision No. 62458 granted, April 14, 2000, and US LEC is authorized to provide service by Decision No. 66740, granted January 20, 2004.

7. PAETEC intends to voluntarily surrender the US LEC Certificate of Convenience and Necessity ("CC&N") and has filed a separate Application for Commission approval under Docket No. T-04194A-07-0624.

8. As of October 31, 2007, PAETEC and its Arizona affiliates are serving 282 customers in the State of Arizona. This number primarily represents business customers but does include some residential customers. PAETEC currently has no Arizona employees.

...

1           9.     PAETEC currently serves major Metropolitan Statistical Areas ("MSA") in 24  
2 States and employs approximately 2,300 people. PAETEC is headquartered in Rochester, New  
3 York, with major operations centers in Charlotte, North Carolina; Mt. Laurel, New Jersey; and  
4 Irvine, California. PAETEC has been operating as a competitive communications provider for  
5 nearly a decade and presently has more than 2.65 million access line equivalents in service as of  
6 June 30, 2007.

7 THE TRANSACTION

8           McLeodUSA Parent and PAETEC in their Application represent the following:

9           10.    PAETEC and McLeodUSA Parent entered into an Agreement and Plan of Merger  
10 dated September 17, 2007.

11           11.    The Agreement provides for a business combination, or merger, of PAETEC and  
12 McLeodUSA Parent by which PAETEC will acquire McLeodUSA Parent in an all-stock merger  
13 and McLeodUSA Parent will be merged into a wholly-owned subsidiary of PAETEC.

14           12.    The PAETEC entity into which McLeodUSA Parent will be merged is a newly  
15 formed entity named PS Acquisition Corp., which was created for the specific purpose of this  
16 transaction.

17           13.    McLeodUSA will be the surviving entity of the merger and will be an indirect,  
18 wholly-owned subsidiary of PAETEC.

19           14.    Although the transaction will result in a change in the ownership and control of  
20 McLeodUSA, no transfer of certificate, assets, or customers will occur as a result of the transfer of  
21 control or McLeodUSA's participation in the debt financing.

22           15.    McLeodUSA will continue to provide service to its Arizona customers pursuant to  
23 its existing certificate and customers will continue to receive service under the same rates, terms,  
24 and conditions of service. The transfer of control and McLeodUSA's participation in the debt  
25 financing will be transparent to the customers of McLeodUSA.

26           16.    PAETEC will acquire McLeodUSA Parent in an all-stock merger for approximately  
27 \$557 million. The merger price consists of approximately \$492 million in PAETEC common  
28 stock and approximately \$65 million in net debt assumption.

1           17.     Current McLeodUSA Parent shareholders will receive 1.30 shares of PAETEC  
2 common stock for every share of McLeodUSA Parent common stock that they own.

3           18.     PAETEC will continue to be headquartered in Fairport, New York, and will  
4 maintain McLeodUSA Parent's operations in Cedar Rapids, Iowa, and other regional centers,  
5 including Tulsa, Oklahoma. After closing of the transaction, PAETEC's current board of directors  
6 will add one director to be designated by certain principal stockholders of McLeodUSA Parent.

7           19.     Under the proposed transaction, McLeodUSA will guarantee the obligations of  
8 PAETEC, as borrower, under the senior secured credit facilities aggregate principal amount of  
9 \$550 million and grant a security interest in all of its assets to secure all amounts owing under the  
10 credit facilities. PAETEC has a \$498 million term loan facility<sup>2</sup> and a \$50 million revolving credit  
11 facility with final maturity dates of February 28, 2013 and February 28, 2012, respectively. Any  
12 proceeds under the revolving credit facility will be used for working capital, capital expenditures,  
13 and other general corporate purposes. Under the terms of the Credit Agreement, each direct and  
14 indirect, current and future subsidiary of PAETEC is required to provide an unconditional  
15 guarantee of all amounts owing under the credit facilities and to grant a security interest in all of its  
16 assets to secure all amounts owing under the credit facilities.

17           20.     McLeodUSA will also guarantee the obligations of PAETEC under the \$300  
18 million aggregate principal amount of PAETEC's 9.5% Senior Notes due in 2015.<sup>3</sup> Subject to  
19 receipt of required governmental approvals, each of PAETEC's current and future wholly-owned  
20 subsidiaries is required to guarantee the Notes on a senior unsecured basis. There is no obligation  
21 for any subsidiary to guarantee the Notes until after such subsidiary obtains such required  
22 governmental approvals.

23           21.     In addition, McLeodUSA intends to incur, guarantee and/or secure additional  
24 borrowings up to a total of \$500 million of additional indebtedness in the form of incremental term

25  
26 <sup>2</sup> Under the term loan facility, borrowings were used to refinance substantially all of the senior secured indebtedness of  
27 PAETEC Corp. (the predecessor of PAETEC) and to repurchase all outstanding shares of the US LEC Corp. preferred  
28 stock in connection with the closing of the merger of PAETEC Corp. and US LEC Corp., in addition to paying the fees  
and expenses incurred in connection with the refinancing and stock repurchase.

<sup>3</sup> The net proceeds of the notes offering, along with cash on hand was used to repay \$300 million principal amount of  
term loans outstanding under the credit facilities. As a result of the partial term loan repayment, the current credit  
facilities consist of the \$498 million term loan and the \$50 million revolving credit facility.

1 loans and additional notes, which are permitted under the credit agreement governing the credit  
2 facilities and under the indenture that governs the terms of the Notes. Any such increased  
3 borrowings may be used for capital expenditures, and general corporate and working capital  
4 purposes.

5 22. The requested encumbrance of McLeodUSA's assets and related guaranty will  
6 replace McLeodUSA's existing encumbrance and guaranty approved by the Commission on  
7 February 20, 2007 in Decision No. 69346.

8 23. McLeodUSA's existing \$600,000 performance bond, which was obtained as a  
9 requirement of Decision No. 64657, will continue to remain in place.

10 THE APPLICANTS REQUEST

11 McLeodUSA Parent, and PAETEC in their Application request that the Commission  
12 approve the following:

- 13 a. The transfer of indirect control of McLeodUSA resulting from the proposed merger  
14 pursuant to A.A.C. R14-2-803; and  
15 b. McLeodUSA's participation in the debt financing arrangements pursuant to A.R.S.  
16 40-285 and A.A.C. R14-2-804.

17 The Applicants also request expedited consideration and approval of this Application  
18 without hearing no later than January 1, 2008.

19 STAFF'S ANALYSIS

20 The Affiliated Interests Rules

21 24. The Public Utility Holding Companies and Affiliated Interests Rules apply to all  
22 Class A – investor-owned utilities, defined as telecommunications carriers that have Arizona  
23 jurisdictional annual revenues of more than \$1 million. In the 2006 Annual Report filed with the  
24 Commission, McLeodUSA generated more than \$1 million of Arizona jurisdictional revenue. The  
25 proposed merger of PAETEC and McLeodUSA Parent will create an entity that is considered a  
26 Class A investor-owned utility. As a result, the Application is subject to A.A.C. R14-2-801  
27 through 805 of the Public Utility Holding Companies and Affiliated Interests Rules.

28 25. In its Application and in response to additional requests by Staff, the Applicants  
provided the following information as required by A.A.C. R14-2-803 (A):

- 1 a. The names and business addresses of the proposed officers and directors of the  
2 holding company;

3 Information concerning PAETEC's directors and officers has been provided  
4 as an attachment to the Application. Both PAETEC's and McLeodUSA's  
5 business addresses have also been provided in the Application.

- 6 b. The business purposes for establishing or reorganizing the holding company;

7 The proposed merger will offer business customers an alternative to legacy  
8 carriers through the combined footprint of the Applicants, along with a  
9 comprehensive suite of business services, and an extensive switching and  
10 fiber network. In addition, the merger should position PAETEC to realize  
11 substantial cost savings and achieve synergies to enhance their service  
12 offerings and provide more advanced telecommunications services to a  
13 broader customer base. The combined managerial and operational expertise  
14 of both PAETEC and McLeodUSA Parent will strengthen the competitive  
15 position of both companies whereby benefiting Arizona consumers and the  
16 telecommunications marketplace within the State of Arizona.

- 17 c. The proposed method of financing the holding company and the resultant capital  
18 structure;

19 As described in the Application, PAETEC is a publicly traded company  
20 with an established capital structure and significant financial resources. The  
21 methods it uses for financing will not change as a result of this transaction.  
22 A newly created subsidiary of PAETEC will merge with McLeodUSA  
23 Parent, with McLeodUSA surviving. PAETEC will issue additional equity  
24 in the company in connection with this transaction, but this will not  
25 materially impact how the company is financed.

- 26 d. The resultant effect on the capital structure of the public utility;

27 The Applicants have indicated that as a result of the merger, PAETEC will  
28 become the new parent of McLeodUSA. The capital structure of the

1 Arizona operating subsidiaries of both PAETEC and McLeodUSA Parent  
2 will be unaffected by the merger.

- 3 e. An organization chart of the holding company that identifies all affiliates and their  
4 relationships within the holding company;

5 The Applicants have provided both pre-merger and post-merger  
6 organization charts as an attachment to the Application.

- 7 f. The proposed method for allocating federal and state income taxes to the  
8 subsidiaries of the holding company;

9 The Applicants have stated that Federal and State income tax allocations  
10 among PAETEC and its subsidiaries are consistent with the provisions of  
11 Treasury Regulation Sections 1.1552-1(a). PAETEC's approach to  
12 allocating tax liability will not change materially as a result of this  
13 transaction.

- 14 g. The anticipated changes in the utility's cost of service and the cost of capital  
15 attributable to the reorganizations;

16 The merger is not expected to have any adverse impact on the cost of  
17 services provided by McLeodUSA and the PAETEC operating subsidiary.

18 The merger should improve all of the operating subsidiaries' access to  
19 capital at favorable rates through their common parent, PAETEC.

- 20 h. A description of diversification plans of affiliates of the holding company; and

21 The Applicants have no current plans for diversification or business  
22 activities unrelated to operations of the current subsidiaries.

- 23 i. Copies of all relevant documents and filings with the United States Securities and  
24 Exchange Commission and other federal or state agencies.

25 The Applicants have made various filings for State and Federal approvals as  
26 required to consummate PAETEC's acquisition of McLeodUSA Parent.  
27 Copies of the documents have been provided to Staff in electronic format.  
28 Documents included filings made with the U.S. Securities and Exchange



Commission, Federal Communications Commission, and many States, such as California, Colorado, Georgia, Mississippi, New York, Pennsylvania, Tennessee, Texas, Delaware, Indiana, Louisiana, Minnesota, Ohio, West Virginia, and the District of Columbia.

- j. The contemplated annual and cumulative investment in each affiliate for the next five years, in dollars and as a percentage of projected net utility plant, and an explanation of the reasons supporting the level of investment and the reasons this level will not increase the risks of investment in the public utility.

PAETEC has indicated that its primary business is providing medium-sized and large business and enterprise organizations in large metropolitan areas with a package of integrated communications services, including local and long distance voice, data, and Internet services. PAETEC's services are currently provided by 12 wholly-owned subsidiaries which, collectively, operate in 48 States and the District of Columbia. To date, PAETEC has not contemplated the annual and cumulative investment in each of these affiliates for the next five years and, therefore, cannot provide the figures requested. However, PAETEC was able to provide confidential two year high level projected capital expenditures for the post-merger combined entity.

- k. An explanation of the manner in which the utility can assure that adequate capital will be available for the construction of necessary new utility plant and for improvements in existing utility plant at no greater cost than if the utility or its affiliate did not organize or reorganize a public utility holding company.

The Applicants represent that the Arizona operating subsidiaries of PAETEC and McLeodUSA Parent will be able to attract capital on terms no less favorable than prior to the merger. Adequate, and probably increased, capital will be available for growth and development in Arizona.

1           26.     The Parties have stated in its Application that McLeodUSA's Arizona customers  
2 will continue to receive service under the same rates, terms, and conditions of service as currently  
3 provided. The proposed merger is not expected to impair the financial status of the Arizona  
4 operating subsidiaries of PAETEC or McLeodUSA Parent; neither preventing them from attracting  
5 capital at fair and reasonable terms, or impairing the ability to provide safe, reasonable, and  
6 adequate service. Based on the information provided, Staff believes the Parties have complied  
7 with the requirements of A.A.C. R14-2-803(C) and 804(C).

8           27.     McLeodUSA requests authorization to pledge its Arizona assets as security for the  
9 debt issuance. A.R.S. §40-285 requires public service corporations to obtain Commission  
10 authorization to encumber certain utility assets. The statute serves to protect captive customers  
11 from a utility's act to dispose of any of its assets that are necessary for the provision of service,  
12 thus, it serves to preempt any service impairment due to disposal of assets essential for providing  
13 service. In this instance, a pledge of McLeodUSA's assets should not impair the availability of  
14 service to customers since McLeodUSA provides competitive services that are available from  
15 alternate service providers. However, customers may still have exposure to losses to the extent  
16 they have prepaid for service or made deposits. Accordingly, Staff finds that any authorization for  
17 encumbrances should provide customer protection for prepayments and deposits.

18 THE PUBLIC INTEREST

19           28.     McLeodUSA is in compliance with Decision No. 69346 in which the Commission  
20 approved an encumbrance of McLeodUSA's assets and a guaranty for certain financing  
21 arrangements of its parent.

22           29.     On February 20, 2007, in Decision No. 69346, the Commission approved  
23 McLeodUSA's pledge of its Arizona assets as security and for McLeodUSA to act as a co-  
24 guarantor for Senior Second Secured Notes issued by McLeodUSA Parent, and to participate in  
25 certain other financing arrangements. This proposed transaction will affect Decision No. 69346  
26 since McLeodUSA will participate in the replacement of the 2006/2007 debt, used to issue the  
27 Senior Second Secured Notes, with a new financing arrangement, however, McLeodUSA's assets  
28

1 will again be encumbered as security for the loans necessary to refinance the existing debt and  
2 purchase in this proposed Application.

3 30. As of November 1, 2007, the combined PAETEC and McLeodUSA companies'  
4 Arizona workforce consisted of approximately 18 employees. PAETEC has indicated that it does  
5 not foresee any Arizona workforce reductions or Arizona plant or facility closings from  
6 McLeodUSA, PAETEC, or any of its Arizona affiliates should this Application be approved by the  
7 Commission.

8 31. The proposed acquisition will allow PAETEC to add network assets including  
9 17,000 fiber-route miles and increase its total number of switches to 116. The combined company  
10 will benefit business customers by allowing it to offer a comprehensive suite of business services,  
11 and an extensive switching and fiber network. The transaction is also expected to strengthen the  
12 ability of the operating subsidiaries, including McLeodUSA and PCI, by allowing them to enhance  
13 their service offerings to Arizona consumers and provide more advanced telecommunications to a  
14 broader customer base. The combined managerial and operational expertise of both PAETEC and  
15 McLeodUSA Parent will also benefit the operating subsidiaries.

16 32. In its Application, the Parties have indicated that through the complementary  
17 strengths, product sets, and geographic footprints of the two companies, PAETEC should realize  
18 substantial cost savings and achieve \$30 million in cumulative cost synergies during the first and  
19 second years following closing of the transaction. PAETEC provided additional information  
20 indicating that the majority of synergy savings will be realized through the elimination of  
21 duplicative spending on network facilities. PAETEC expects to streamline its network through  
22 additional volume discounts on long distance and local wholesale services, consolidation of  
23 signaling networks, and consolidation of duplicative switching and collocation centers. Due to  
24 increased volume commitments through mergers and acquisitions, PAETEC anticipates lower per  
25 unit costs from its wholesale vendors, such as Qwest, Global Crossing, and AT&T, who build their  
26 networks that support toll free services which PAETEC offers to its business customers. The  
27 lower per unit costs will allow PAETEC to more competitively price the service to its retail  
28 customer base, including its customers in Arizona.

1           33.     The Applicants have indicated that McLeodUSA has invested \$40.52 million in  
2 telecommunications equipment in Arizona, primarily consisting of one Class 5 switch, one soft  
3 switch, 28 collocations, and a limited amount of intercity fiber. PAETEC, currently, has no  
4 physical presence in Arizona and, therefore, the value of its investment in Arizona is zero.  
5 PAETEC provided Staff with confidential high level projected capital expenditures for 2008 and  
6 2009 for the post-merger combined entity.

7           34.     In Decision No. 69346, the Commission approved McLeodUSA's request for  
8 authorization to issue guarantees and pledge its Arizona assets as security for certain financing  
9 arrangements of its parent McLeodUSA Parent. In a private offering on September 28, 2006,  
10 McLeodUSA Parent issued approximately \$120 million in 10½ percent Senior Secured Notes due  
11 in 2011. As part of the financing arrangement, McLeodUSA Parent agreed to exchange the Senior  
12 Secured Notes for substantially identical notes, registered under the Federal Securities Laws,  
13 within 180 days. Subject to certain conditions, McLeodUSA Parent and its subsidiaries were  
14 allowed to incur additional debt and grant additional liens on their assets, including incurring new  
15 debt up to \$26 million in aggregate principal amount.

16           35.     McLeodUSA now seeks the authorization to guarantee the obligations of PAETEC,  
17 as borrower, under Senior Secured Credit Facilities of \$550 million aggregate principal amount;  
18 grant a security interest in all of its assets to secure all amounts owing under the Credit Facilities;  
19 guarantee the obligations of PAETEC under the \$300 million aggregate principal amount of  
20 PAETEC's 9.5% Senior Notes due 2015; and incur, guarantee, and/or secure additional  
21 borrowings of up to \$500 million of additional indebtedness in the form of incremental term loans  
22 and additional notes. This new encumbrance of McLeodUSA's assets and related guaranty will  
23 replace McLeodUSA's existing encumbrance and guaranty approved by the Commission in  
24 Decision No. 69346.

25           36.     The Applicants have indicated that McLeodUSA's existing \$600,000 performance  
26 bond, which was obtained as a requirement of Decision No. 64657, granted March 25, 2002, will  
27 continue to remain in place. McLeodUSA currently holds deposits from Arizona customers  
28 totaling \$7,346.86. No customer deposits are being held in Arizona by any other affiliates of

1 McLeodUSA Parent. PAETEC and its affiliates are not holding any deposits from Arizona  
2 customers. PAETEC has indicated that it is of the understanding that McLeodUSA's \$600,000  
3 performance bond, currently in place, cannot be used in the encumbrance of assets.

4 37. In the Application, PAETEC will acquire McLeodUSA Parent in an all-stock  
5 merger for approximately \$557 million. The merger price consists of approximately \$492 million  
6 in PAETEC common stock and approximately \$65 million in net debt assumption. Current  
7 McLeodUSA Parent shareholders will receive 1.30 shares of PAETEC common stock for every  
8 share of McLeodUSA Parent common stock that they own.<sup>4</sup> As indicated previously, the proposed  
9 transaction will have no impact on the rates, terms and conditions of service currently provided to  
10 customers of McLeodUSA. As supported by the information previously provided, Staff believes  
11 that the proposed transaction will not impair the financial status of the Arizona operating  
12 subsidiaries of PAETEC or McLeodUSA Parent; nor prevent the Applicants' ability to attract  
13 capital at fair and reasonable terms and to provide safe, reasonable, and adequate service.

14 38. Pursuant to A.A.C. R14-2-805, McLeodUSA is up to date with filing its 2006  
15 annual diversification activities and plans. PAETEC and its Arizona affiliates combined Arizona  
16 annual operating revenues do not exceed \$1 million; therefore PAETEC is not subject to A.C.C.  
17 R14-2-805. The Compliance Division has stated that there are no delinquencies for PAETEC and  
18 McLeodUSA. Staff has verified that the 2006 annual reports of McLeodUSA and PAETEC and  
19 its Arizona subsidiaries are on file with the Commission and up to date. On December 4, 2007, the  
20 Corporations Division reports that McLeodUSA and the other 3 Arizona affiliates of McLeodUSA  
21 Parent are in good standing. In addition, the 2 Arizona subsidiaries of PAETEC are also in good  
22 standing.

23 39. Both PAETEC and McLeodUSA have indicated that there are no outstanding or  
24 unresolved consumer complaints pending with this Commission. Staff's search of the Consumer  
25 Services database for the past 3 years through December 4, 2007 for McLeodUSA, indicates a

26 \_\_\_\_\_  
27 <sup>4</sup> It is noted in the Application, that approximately 40 million shares of PAETEC common stock will be issued to  
28 shareholders of currently outstanding McLeodUSA Parent stock. PAETEC has approximately 102.1 million shares of  
common stock currently outstanding. McLeodUSA Parent's employee stock options, of which 2.7 million are  
outstanding, will be converted into options to purchase PAETEC shares, to the extent not exercised before closing.

1 total of 20 complaints, 6 inquiries, and 1 opinion, and that all complaints have been resolved and  
2 closed. During that same time period, no complaints, inquiries, or opinions have been filed on the  
3 other McLeod Parent Arizona affiliates or PAETEC Arizona subsidiaries.

4 40. On December 12, 2007, the Applicants submitted an Affidavit of Publication  
5 confirming publication of a legal notice relative to the proposed transaction in *The Arizona*  
6 *Republic* on December 10, 2007. The Applicants have also provided Staff with a draft of a direct  
7 mailing that will be provided to the McLeodUSA customers following a decision in this matter.  
8 Staff has reviewed the proposed customer notice and concludes that it is consistent with  
9 Commission requirements.

10 41. Staff is not aware of any concerns or objections filed by any entity or individual.  
11 Staff reviewed the Application and supplemental filings, and considered all responses to Staff's  
12 data requests.

13 STAFF'S RECOMMENDATIONS

14 42. Staff recommends that the Application of PAETEC and McLeodUSA Parent for a  
15 transfer of control of McLeodUSA to PAETEC, resulting from the proposed merger, be approved  
16 pursuant to A.A.C. R14-2-803.

17 43. Staff recommends that the Application of PAETEC and McLeodUSA Parent for  
18 McLeodUSA's participation in debt financing arrangements be approved pursuant to A.R.S. 40-  
19 285 and A.A.C. R14-2-804.

20 44. Staff also recommends that the Application be approved without a hearing because  
21 Staff believes this transaction does not:

- 22 a. impair the financial status of the Applicants;
- 23 b. prevent the Applicants' ability to attract capital at fair and reasonable terms;
- 24 c. prevent the Applicants' ability to provide safe, reasonable and adequate  
25 service;
- 26 d. adversely affect customers.

27 45. Staff further recommends that approval be conditioned on the following:

- 28 a. That PAETEC provides notice to the Commission within 30 days following  
the acquisition close proposed in this transaction.

- 1           b.     That for one year following acquisition close or until PAETEC and  
2           McLeodUSA Parent informs the Commission by filing an affidavit with  
3           Docket Control that acquisition-related activities are completed, whichever  
4           occurs last, PAETEC and McLeodUSA Parent provide written notification  
5           to the Director of the Utilities Division and to the individual members of the  
6           Commission, at least 60 days in advance, of any planned acquisition-related  
7           Arizona workforce layoffs; any planned acquisition-related Arizona plant  
8           closings; and any planned acquisition-related Arizona facility closings.
- 9           c.     That McLeodUSA Parent and PAETEC provide the Compliance Section  
10          with updates by April 15, 2008 and April 15, 2009 on the status of plans to  
11          increase employees and investment in Arizona.
- 12          d.     That McLeodUSA Parent and PAETEC provide the Compliance Section  
13          with updates by April 15, 2008 and April 15, 2009 of any changes in the  
14          status of debt financing plans.
- 15          e.     That PAETEC be limited from pledging any customer deposits, advances, or  
16          prepayments currently held by McLeodUSA or which may be held by  
17          McLeodUSA and/or PAETEC in the future, as debt security.
- 18          f.     That PAETEC shall file, as an annual compliance item in this docket, a  
19          notarized attestation from an Officer stating whether all Arizona customer  
20          deposits, advances, and prepayments are excluded from encumbrance, or  
21          whether they are secured by a performance bond or irrevocable sight draft  
22          Letter of Credit which is not included in the pledged collateral.
- 23          g.     That PAETEC notifies the McLeodUSA customers of the acquisition  
24          through a direct mailing to the McLeodUSA customers. Verification of the  
25          notice should be filed with Docket Control within 90 days of a decision in  
26          this matter.

#### CONCLUSIONS OF LAW

- 25          1.     PAETEC, McLeodUSA Parent, and McLeodUSA are public service corporations  
26          within the meaning of Article XV of the Arizona Constitution.
- 27          2.     The Commission has jurisdiction over McLeodUSA and the subject matter in this  
28          filing.

## ORDER

...



1 IT IS FURTHER ORDERED that PAETEC and McLeodUSA Parent provide the  
2 Compliance Section with updates by April 15, 2008 and April 15, 2009 of any changes in the  
3 status of debt financing plans.

4 IT IS FURTHER ORDERED that PAETEC, McLeodUSA Parent, and McLeodUSA be  
5 limited from pledging any customer deposits, advances, or prepayments currently held by  
6 McLeodUSA or which may be held by McLeodUSA and/or PAETEC in the future, as debt  
7 security.

8 IT IS FURTHER ORDERED that PAETEC shall file, as an annual compliance item in this  
9 docket, a notarized attestation from an Officer of the Company stating whether all Arizona  
10 customer deposits, advances, and prepayments are excluded from encumbrance, or whether they  
11 are secured by a performance bond or irrevocable sight draft Letter of Credit which is not included  
12 in the pledged collateral.

13 IT IS FURTHER ORDERED that PAETEC completes the recommended notice to the  
14 McLeodUSA customers of the proposed acquisition and financing through a direct mailing to the  
15 McLeodUSA customers.

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1 IT IS FURTHER ORDERED that PAETEC file verification that the notice has been  
2 completed with Docket Control within 90 days of a decision in this matter.

3 IT IS FURTHER ORDERED that this Decision shall become effective immediately.

4  
5 **BY THE ORDER OF THE ARIZONA CORPORATION COMMISSION**

6  
7   
8 CHAIRMAN

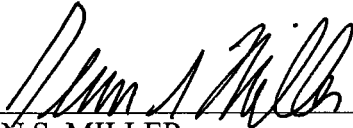
9   
10 COMMISSIONER

11 COMMISSIONER

12   
13 COMMISSIONER

14   
15 COMMISSIONER

16  
17 IN WITNESS WHEREOF, I DEAN S. MILLER, Interim  
18 Executive Director of the Arizona Corporation Commission,  
19 have hereunto, set my hand and caused the official seal of  
20 this Commission to be affixed at the Capitol, in the City of  
21 Phoenix, this 23<sup>rd</sup> day of January, 2008.

22   
23 DEAN S. MILLER  
24 Interim Executive Director

25 DISSENT: \_\_\_\_\_

26 DISSENT: \_\_\_\_\_

27 EGJ:PJG:tdp/MAS  
28

SERVICE LIST FOR: PAETEC Holding Corp., McLeodUSA Inc., and McLeodUSA  
Telecommunications, Services, Inc.

DOCKET NO. T-03267A-07-0554

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